MOODY'S
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CREDIT OPINION
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Update

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State of Alaska

Rating Update: Moody's Downgrades Alaska to Aa2; Outlook Remains Negative

Summary Rating Rationale

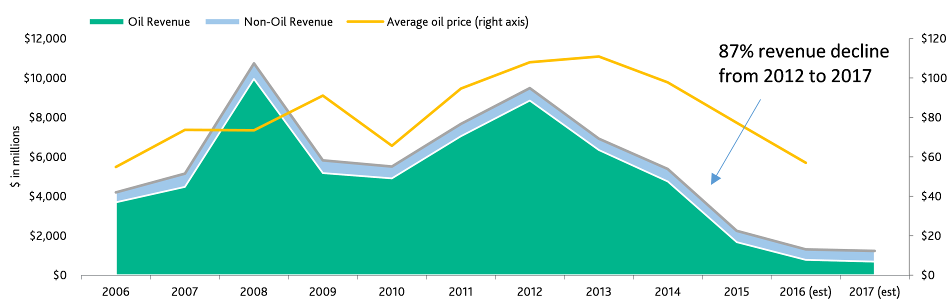
Moody's Investors Service has downgraded the State of Alaska's general obligation rating to Aa2 from Aa1. The outlook remains negative.

The downgrade recognizes the state's political inability – at least for now – to address its severe fiscal challenges.

The Aa2 rating incorporates the state's extraordinary structural imbalance, under which it is running deficits of more than $3 billion per year, as well as its outsized pension liabilities and the economic difficulties caused by low oil prices. The rating also reflects the extremely large available reserves Alaska has, which buy it several more years to figure out what its fiscal future will look like. Our baseline assumption remains that the state will come to a political compromise to achieve a sustainable fiscal structure before coming close to depleting its reserves.

Moody's has also downgraded the state's lease-appropriation bonds to Aa3 from Aa2 and its moral obligation bonds to A1 from Aa3. These bonds continue to be rated one and two notches lower than the state's general obligation rating, respectively.

Exhibit 1
Alaska's Revenues Have Plummeted Along with Oil Prices



Note: Oil price is the average North Slope spot price for the fiscal year ending June 30.
Source: State of Alaska

Credit Strengths

» Enormous available cash reserves

» Willingness to cut expenditures to move closer to budget balance

Credit Challenges

» Large structural budget imbalance

» Lack of political consensus so far on plan for rectifying structural imbalance

» Outsize pension liabilities

» Historical reliance on oil-related revenues, which are now in decline

Rating Outlook

The negative outlook incorporates the uncertainty about Alaska's inability so far to achieve a more sustainable fiscal identity through political solutions. As the state spends down its reserves – which are still enormous – the risks to the state's long-term credit profile will intensify.

Factors that Could Lead to an Upgrade (Removal of Negative Outlook)

» Achievement of a sustainable solution to the state's structural imbalance

» Economic recovery leading to more predictable fiscal operations

Factors that Could Lead to a Downgrade

» Prolonged delays in achieving a budget solution, leading to significant further draws on available reserves

» Continued growth in long-term liabilities

Key Indicators

Exhibit 2

Alaska	FY 2011	FY 2012	FY 2013	FY 2014	FY 2015
Operating Fund Revenues (000s)	9,217,341	10,785,224	8,577,583	7,706,982	3,678,644
Balances as % of Operating Fund Revenues	206.1%	211.0%	301.6%	353.2%	579.0%
Net Tax-Supported Debt (000s)	1,050,800	914,900	1,156,400	1,097,200	1,050,300
Net Tax-Supported Debt/Personal Income	3.3%	2.8%	3.2%	3.0%	2.7%
Net Tax-Supported Debt/Personal Income 50 State Median	2.8%	2.8%	2.6%	2.5%	2.5%
Debt/All Governmental Funds Revenue	5.5%	6.8%	7.3%	6.5%	13.0%
Debt/All Governmental Funds Revenue 50 State Median*	22.7%	24.3%	23.8%	23.0%	20.4%
Adjusted Net Pension Liability/All Govt Funds Revenue	55.2%	74.0%	99.3%	85.2%	N/A
Adjusted Net Pension Liability/All Govt Funds Revenue 50 State Median	48.7%	63.9%	60.3%	59.2%	N/A
Total Non-Farm Employment Change (CY)	1.7%	1.5%	0.5%	0.5%	0.5%
Per Capita Income as a % of US (CY)	119.1%	118.1%	115.3%	117.3%	117.4%

Source: Moody's Investors Service

Recent Developments

The state legislature adjourned a special session earlier this week without approving any of Gov. Bill Walker's proposals to fundamentally overhaul the state's fiscal architecture, or any alternatives. The state therefore kicks off 2017 with a budget deficit of more than $3 billion and no plan in place to rectify it.

Detailed Rating Considerations

Economy

Low oil prices are hobbling Alaska's economy, which is poorly diversified and has historically relied heavily on the energy industry. The state's $50 billion economy is in recession, which we expect to continue for the next several quarters.

The state's job growth is the sixth-slowest in the nation as energy firms have been downsizing since early 2015. The state's unemployment rate as of May was 6.7%, much higher than the US rate of 4.7% and the highest of any state.

Over the long run, we expect the state's economy to underperform, as subdued population growth and declining oil production on the North Slope ensure employment and output gains track below those in the nation.

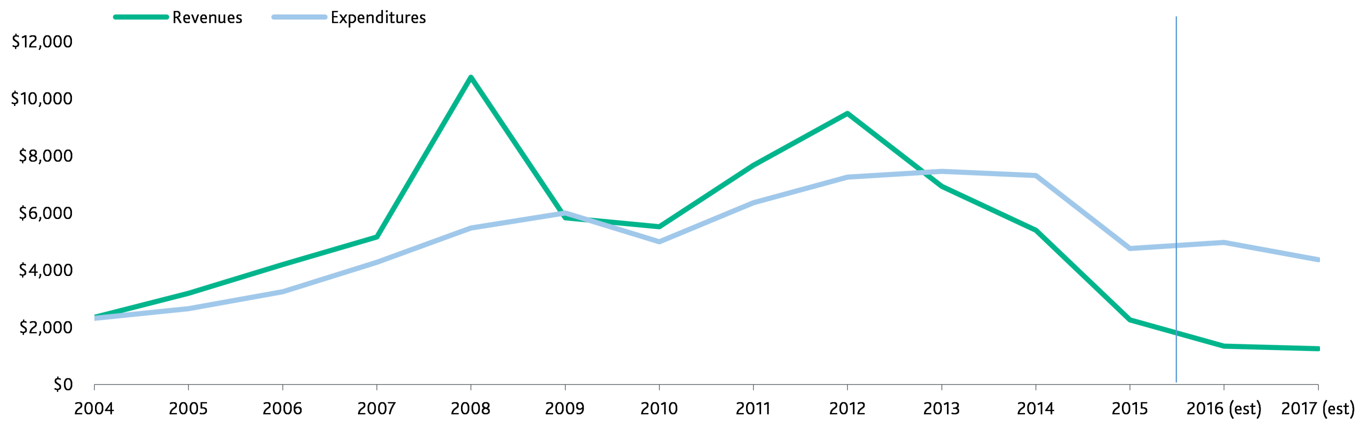
Finances and Liquidity

Alaska's fiscal position is deeply imbalanced and it is not clear when the state will be able to recover.

The reason for the imbalance is that the state once derived more than 90% of its unrestricted general fund revenues from taxes, royalties, and other types of charges on the oil industry. As oil prices rose, the state's revenues (as well as its expenditures) rose along with them. Then, when oil prices fell, the state's revenues fell too – but not as fast as its expenditures (see exhibit).

Exhibit 3

Alaska's Revenues Have Fallen More Sharply Than Expenditures(Note: 2017 expenditures are pro forma to account for governor's vetoes)

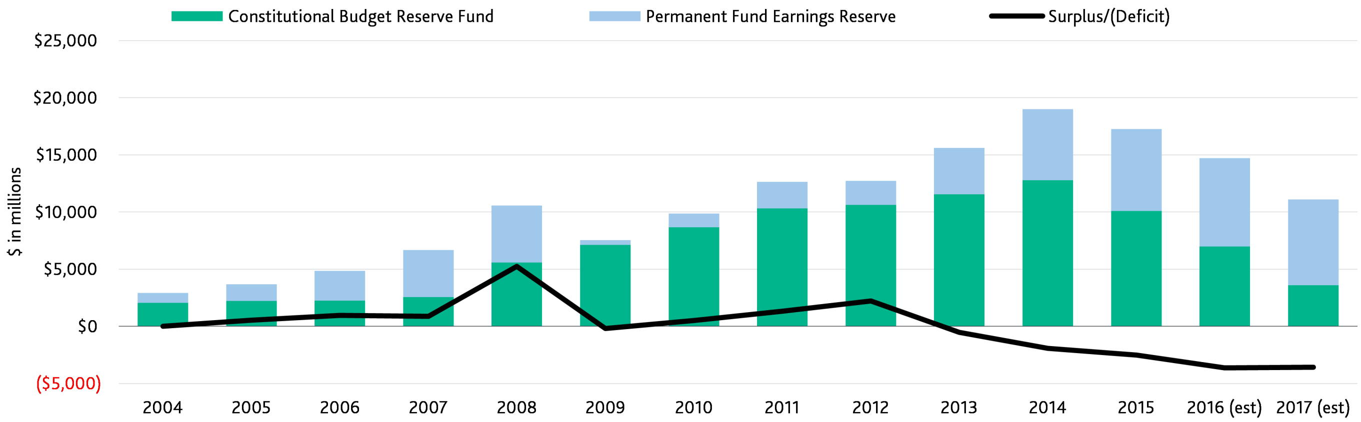


Source: State of Alaska

To put this into perspective, the state's unrestricted general fund revenues in 2012 were $9.5 billion and its expenditures were $7.3 billion. In 2015, revenues were $2.3 billion and expenditures were $4.8 billion. With the price of oil having collapsed to about $50 per barrel from more than $100, the state projects unrestricted general fund revenues of just $1.2 billion this year. Nor would a rebound in oil prices be likely to help much, because the state's revenues will be sufficient to cover current expenses only when oil prices exceed $100 per barrel.

The state's accumulation of enormous reserves during the oil boom means it is capable of running deficits for several years. With each deficit, though, the state's fiscal resources dwindle further and the risks to its long-term credit profile intensify.

Exhibit 4
Alaska Still Has Ample Reserves



Note: Both the Constitutional Budget Reserve Fund and the Permanent Fund Earnings Reserve are available balances to finance the state's general fund.
Source: State of Alaska

For now, the state is running annual deficits of about $3 billion. At the current rate, Alaska would not deplete its reserves until approximately 2021.

Exhibit 5
Alaska Projected to Continue Depleting Reserves

Projections	Projected Deficit	Remaining Balance at the Beginning of the Year	Year-End Balance
2016	($3,634)	$17,264	$14,721
2017	($3,570)	$14,721	$11,116
2018	($3,371)	$11,116	$8,256
2019	($3,277)	$8,256	$5,650

Note: Balance is the sum of the CBRF and the PFER
Source: State of Alaska

How Alaska will return to fiscal balance remains uncertain. The governor proposed a structural overhaul of the state's fiscal operations that would fund the general fund budget primarily from investment earnings from the state's $54 billion Permanent Fund. The permanent fund – which was constitutionally created in 1977 and into which the state deposits up to half of certain oil revenues – is currently used to fund dividends to citizens. The governor's plan contemplates instead transferring $3.3 billion of Permanent Fund investment earnings (targeting a 6% annual return assumption) annually to the general fund, and funding the citizens' dividends with oil-related revenues. That plan would effectively shift the oil price volatility risk from the general fund to citizens.

If the Permanent Fund could in fact generate $3.3 billion of annual investment earnings for the general fund, the state estimates annual revenues of about $4.5 billion, which would represent a more sustainable level of funding for the state's budget based on current spending levels.

The legislature did not approve the governor's plan or any alternative. Instead, the state passed another imbalanced budget for 2017 (about $1.2 billion of projected revenue against $4.4 billion of authorized spending). That raises the prospect of another $3 billion deficit and another year of uncertainty about how the state will fund itself in the future.

LIQUIDITY

Alaska has abundant liquidity. The state treasurer holds cash in various investment pools, and by any measure the state has ample liquidity to meet any short-term needs that could reasonably arise.

The Constitutional Budget Reserve alone has $7.3 billion of cash at the treasury. Another account for the general fund and other non-segregated funds holds an additional $3.5 billion.

The general fund reported $14.8 billion of cash as of the end of fiscal 2015, though this is likely somewhat lower right now because of the $3 billion deficit in 2016.

Debt and Pensions

Alaska carries heavy long-term liabilities, and its pensions will remain a long-term risk particularly in light of the lack of clarity surrounding the state's annual deficits.

Alaska's net tax supported debt – consisting mainly of general obligation bonds -- is moderate.

Exhibit 6

Alaska's Debt is Moderate

Debt Metric	Alaska	US Median	Rank (Lower Number is Higher Liability)
Debt per capita	$1,422	$1,025	19
Debt to personal income	2.7%	2.5%	22
Debt to GDP	1.9%	2.2%	30
Debt service ratio	2.4%	4.3%	39

Source: Moody's Investors Service

PENSIONS AND OPEB

Alaska's pension liabilities are heavy – by some important measures the heaviest of all states. As of June 30, 2014, according to the 2015 Comprehensive Annual Financial Report, the net pension liabilities of the state's five pension plans are $7.7 billion on an actuarial basis. After making our standard adjustments, we estimate the state's share of the plans' adjusted net pension liabilities at $12.6 billion.

How heavy a $12.6 billion liability is depends on how it's measured. Relative to revenues, this has historically not looked like an outsize liability, because the state's revenues were exploding thanks to higher oil prices. However, relative to income, or on a per-capita basis, Alaska's pension liabilities are the highest of all states and a major outlier at the current rating category.

Exhibit 7

Alaska's Pension Levels are Quite High Relative to Income or on a Per Capita Basis

Pension Metric	Alaska	US Median	Rank (Lower Number is Higher Liability)
ANPL to governmental revenues (3-year average)	80%	53%	18
ANPL to personal income	35.9%	8.0%	1
ANPL to GDP	25.0%	6.8%	2
ANPL per capita	$19,394	$3,100	1

Source: Moody's Investors Service

Alaska's adjusted net pension liabilities to personal income are even higher than Illinois' (Baa2 negative) or New Jersey's (A2 negative).

Based on a decision by its Supreme Court, Alaska is one of the few states that constitutionally guarantees other post-employment (OPEB) benefits. When the state's ANPL is recalculated to include both the pension and OPEB liability, its pension ratios grow significantly, from 85% of revenue to 169%.

Governance

We have historically taken a positive view of the state's governance, given its adherence to financial best practices such as multi-year financial planning, the lack of caps on revenue raising or spending, and the governor's line-item veto authority for the budget.

However, the passage of an imbalanced budget for fiscal 2017 and the current exceptional pace of deficit spending is challenging our view that the state has the capacity to quickly address fiscal problems within its current governance framework. Our baseline assumption remains that the state will come to a political compromise and reach a sustainable solution to its imbalance before coming close to depleting its reserves. Continuing failure to agree on a solution will cast doubt on this assumption and further pressure the state's long-term credit profile.

Legal Security

The state's general obligation bonds are secured by its full faith and credit pledge.

The state's lease-appropriation bonds and certificates of participation are secured by its commitment to pay debt service subject to appropriation by the legislature.

The state's moral obligation bonds – primarily the Alaska Municipal Bond Bank – are secured by the state's commitment to consider replenishing any draws on a debt service reserve fund for the bonds.

Use of Proceeds

Not applicable.

Obligor Profile

Alaska is the largest state based on land mass, but its population ranks 48th among the states, at 738,000. Its GDP ranks 43rd.

Methodology

The principal methodology used in the general obligation rating was US States Rating Methodology published in April 2013. The principal methodology used in the lease-backed rating was The Fundamentals of Credit Analysis for Lease-Backed Municipal Obligations published in December 2011. The principal methodology used in the moral obligation rating was Moody's Approach To The Moral Obligation Pledge published in November 2008. Please see the Ratings Methodologies page on www.moodys.com for a copy of these methodologies.

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